May 31, 2011

Dear clients and colleagues,

In our last comment, we mentioned the Chinese government plan to spend huge amounts in coming years to expand access to free and modern healthcare. We will discuss the plan in more details in upcoming comments. Many large multinational pharmaceutical companies and healthcare companies are present and growing fast in China. The company we will profile this week has seen its growth from emerging markets accelerate in the last few years to reach over 30% of its revenues. That company is a world leading company in the field of eye diseases, Carl Zeiss Meditec (AFX GR - €16.05) http://www.meditec.zeiss.com/.

Business overview and history

Carl Zeiss Meditec is a subsidiary of Carl Zeiss AG (65% owner), a German manufacturer of optical systems, industrial measurements and medical devices, founded in Jena Germany in 1846 and listed in Frankfurt since its 2000 IPO.

The company is divided in Ophthalmology/Optometry, Neurosurgery/ENT/Spine, Dentistry and Radiotherapy/Gynecology. In the field of ophtalmology, the company offers complete solutions for treating the four main eye ailments: vision defects (refraction); cataracts; glaucoma; and retinal disorders. In the field of Neuro/Ear, Nose and Throat (ENT) surgery, a fast growing market, the company is the world's leading provider of surgical microscopes and visualization solutions for these treatments, Finally, in the field of radiotherapy and cancer, the company has promising new technologies such as intraoperative radiation therapy which allows the targeted treatment of breast cancer and brain cancer during the operation stage itself.

The market

The markets that Carl Zeiss Meditec participates in are growing at rates varying between 4 and 20% per year. The company is focusing on three trends that affect by a rapidly aging population: loss of mobility; loss of vision; and loss of cognitive abilities.

The number of older people is increasing significantly worldwide. By 2025, around 20% of the world's population will be over 65. A growing number of people are thus reaching an age at which eye diseases, for example, become inevitable. One of the most frequently performed operations on human beings is for cataracts. 40% of people will have cataracts. Another 15% will have glaucoma or AMD, with 1 person going blind every second from it. And for cancer, it is the leading cause of death in the developed world and it is estimated that around 30% of people will suffer from cancer in their lives.

Competitive advantages and competition

Carl Zeiss Meditec competes in a market with few but very large companies such as Alcon, Phillips, GE Medical, etc.

In the area of ophthalmology, the company is a leader with a market share in excess of 50%. In other areas, it is an emerging player competing for a niche or with a small market share.

One of its competitive advantages is its focus on eye diseases, helped by over 100 years of research and innovation. The company is also an innovator with over 10% of sales spent on R&D, not including the ties to the mother company. Finally, the company maintains a global presence of customer focused experts.

Growth strategy

New products are an important component of the growth strategy. For example, in the field of breast cancer, one of the leading causes of death for women, the company has developed its Targeted Intraoperative Radiation Therapy (targit) which has the potential to revolutionize current treatments by being less invasive and allowing women to preserve their breast.

The other vector of growth for the company is to increase its distribution capabilities, particularly in emerging markets, its fastest growth area.

Management

Dr. Ludwin Monz, CEO, 47 years-old, has been with the Carl Zeiss group since 1994 and joined Carl Zeiss Meditec in 2000, managing two of its three business units, before being named CEO in 2008. Most senior managers have been with the group for many years. In addition, the company benefits from its ties with the much larger Carl Zeiss AG, its controlling shareholder.

Risks

As for most medical technology companies, the risk is of technological obsolescence, highly unlikely in this case.

Market data

Market Cap €1300M, net cash €200M, P/E (09/2012) 18.1x, EV/EBITDA (09/2012) 8.6x, dividend yield 1.4%, gross margin 55%, profit margin 9%.

Valuation

We use a DCF model with a growth rate of 12% for the next 10 years and a growth rate at maturity of 7% and a risk premium of 7%. Our target price is €28.72.

Have a good week.

The Global Alpha Team